

Entrepreneurship & Innovation

Prepared by Dr. Amany Ramadan

ENT 611

Lecture 8



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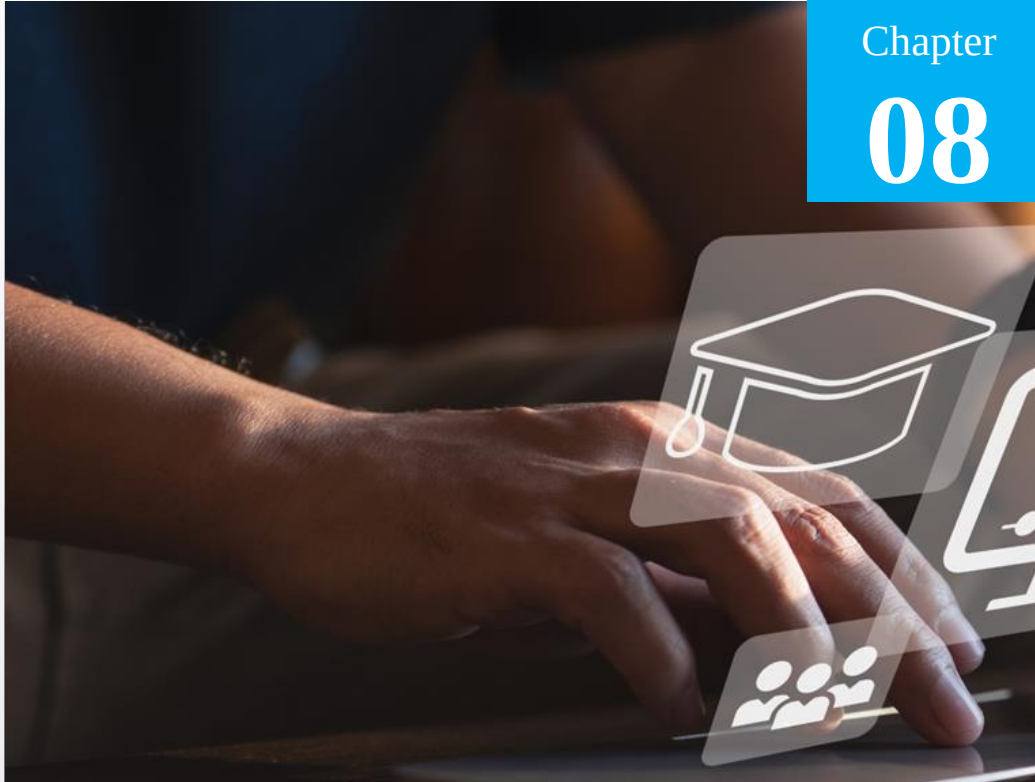
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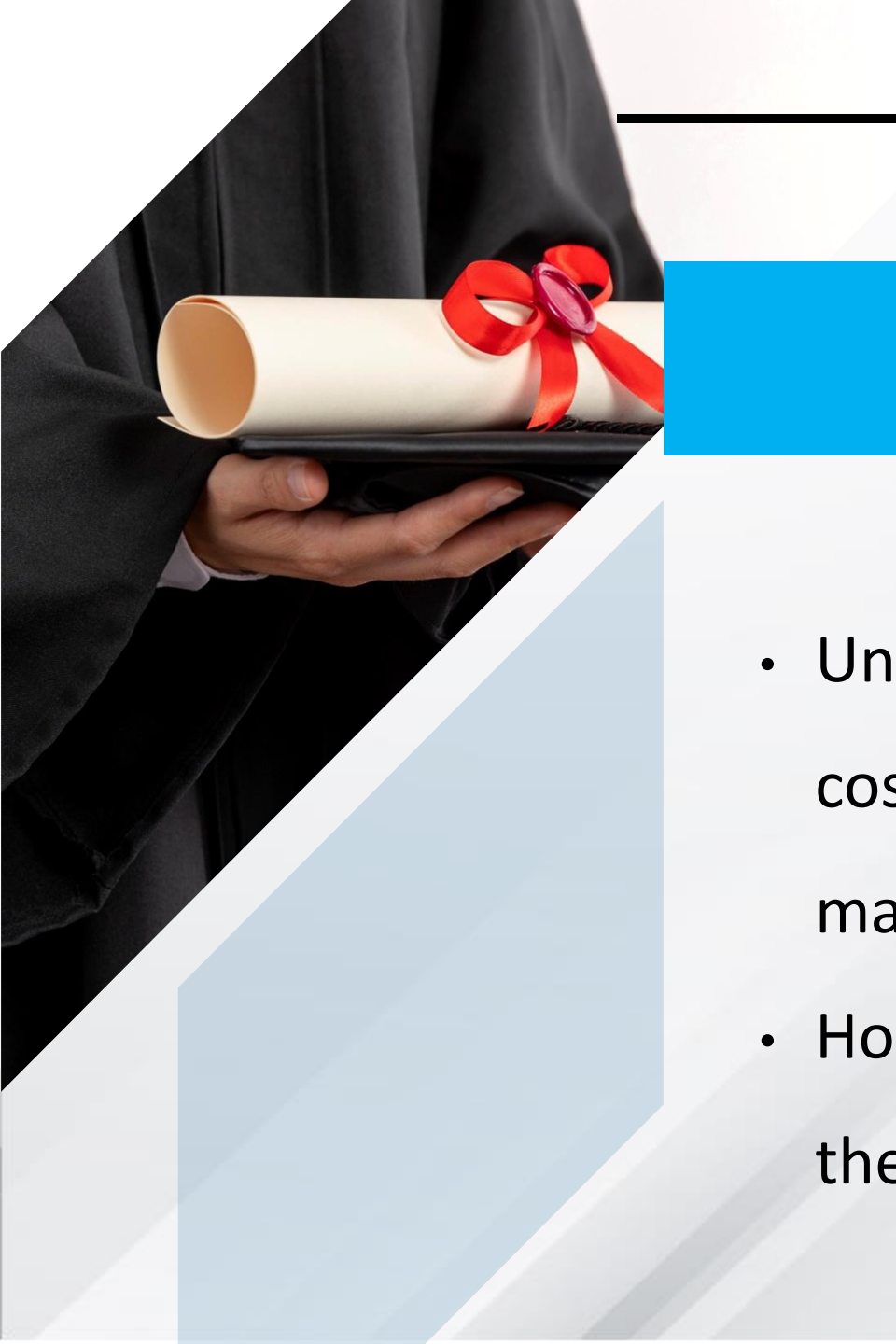
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Chapter

08

Understanding resources and costs, and the ability to meet demand





Learning objectives

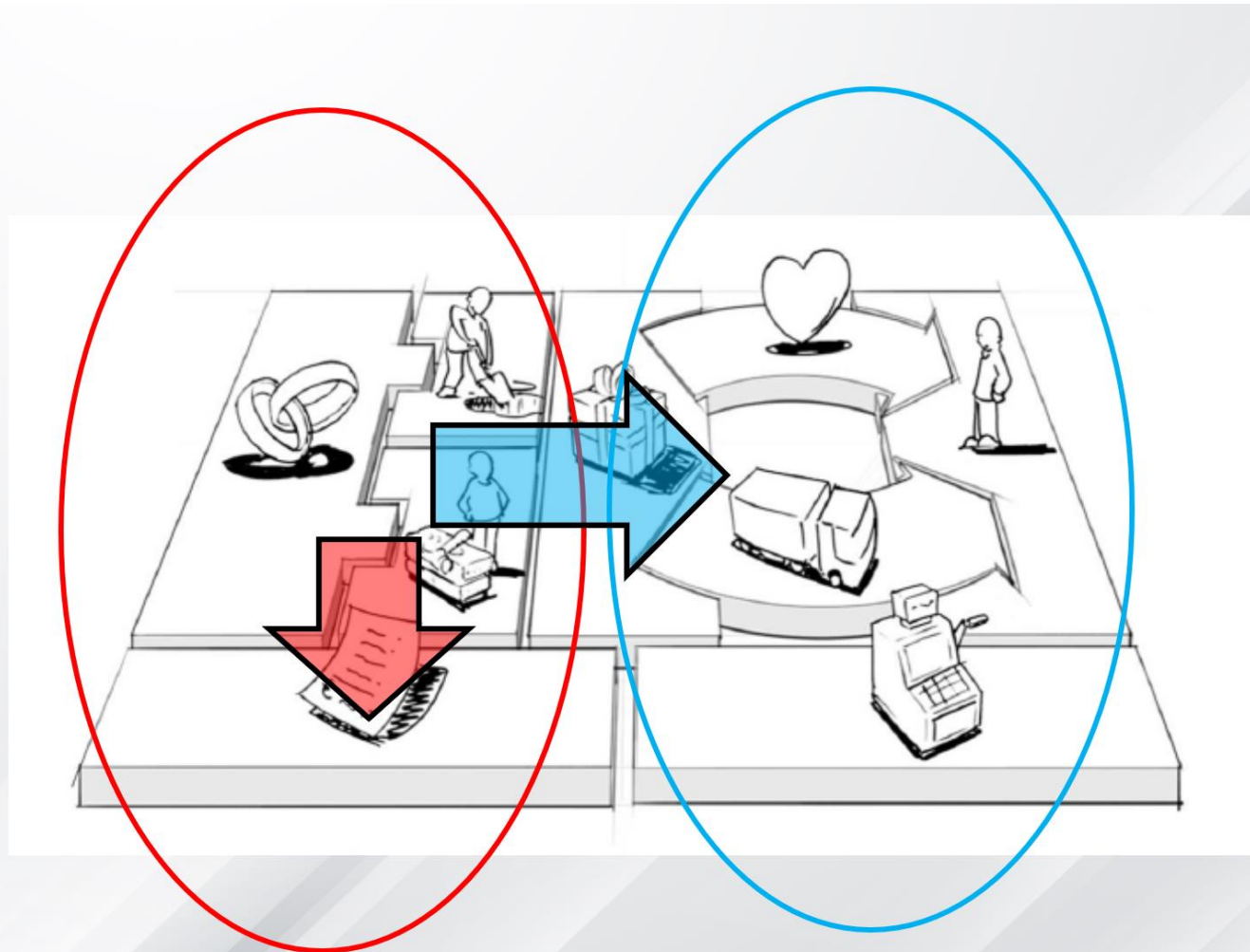
- Understand that creating value generates costs and how this influences business model management
- How to structure costs – reviewing costs and the breakeven model



Value proposition

Congratulations!
Your business idea is brilliant!
Now what?





- How is your business going to be run and how is your product or service going to be produced?
- What are the most important issues?
- To a certain extent depends on the nature of the business eg. New product differing requirements to retail operation.

All operations are transformation processes



Process

- What are your inputs?
- Where will they be sourced from and how much will they cost?
- Detail equipment, raw materials, services, running costs.
- Detail the channels through which you are going to reach the customers.

Operations and human resource requirements

- **People**
 - Management team?
 - Specialities
 - What are their duties?
 - What are your current personnel needs?
 - What skills/roles do you need to source elsewhere
 - Where will you source this from – internal or external?
 - Salaries, benefits?
 - Attract and keep staff/skills/expertise in context of industry

Operations and human resource requirements

- Location
 - Where will you be located?
 - In what type of premises?
 - The advantages eg visibility, access
 - How close to markets/suppliers?
 - How you will get product to market or market to service?
 - How will supplies get to you?
 - COSTS of these? (buy or rent?)
 - Consider any legal requirements.

Example exercise: features and benefits

Features

Our fitness centre, which is just for adults, has 16 exercise classes, a pool that is available for water aerobics and open swims, and a full spa and massage service

Benefits

Our fitness centre, which is just for adults, will feature classes and exercise equipment that help adults maintain their fitness and lead healthier lives

This statement focuses on the benefits, potential customers are left feeling that joining this centre will enhance their lives.

- **Features** are those things that make up the product/service – its practical utility
- **Benefits** are those things that people perceive they are buying
- Understanding of features and benefits of your product/service will help you identify a market, target a market and price more appropriately.

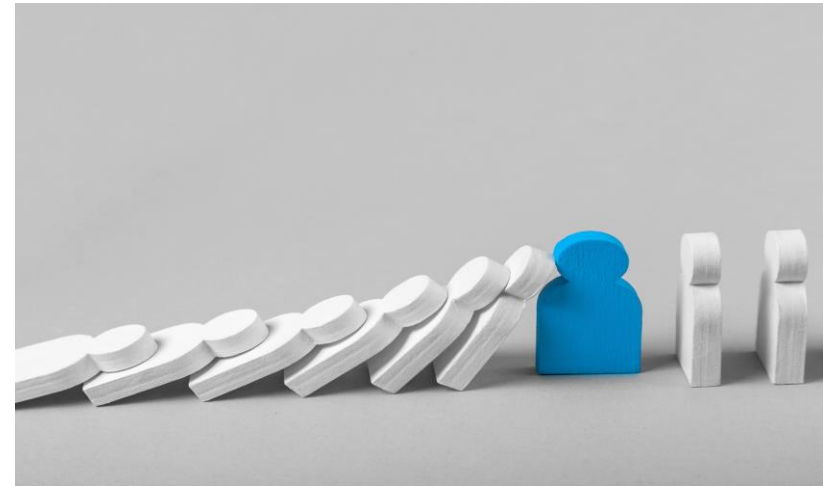
Also

- You have to know the features in order to set up an operation to deliver these.
- You have to know the benefits as the basis of your promotional plan

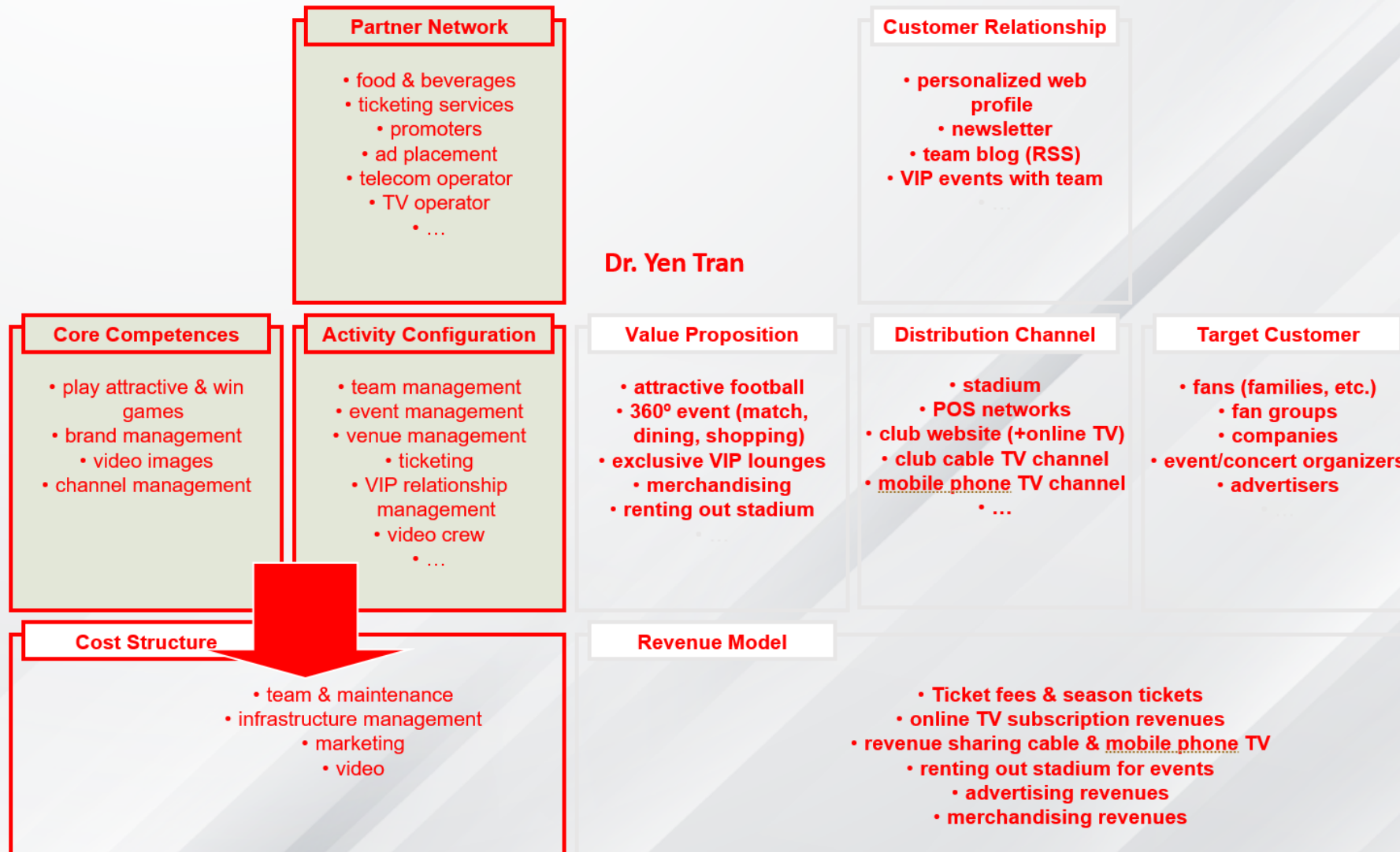
Now in your groups...

- What are the features of your product/service?
- What are the benefits for the customer?
- What inputs (resources, activities, partnerships) are required?
- What do these inputs cost?

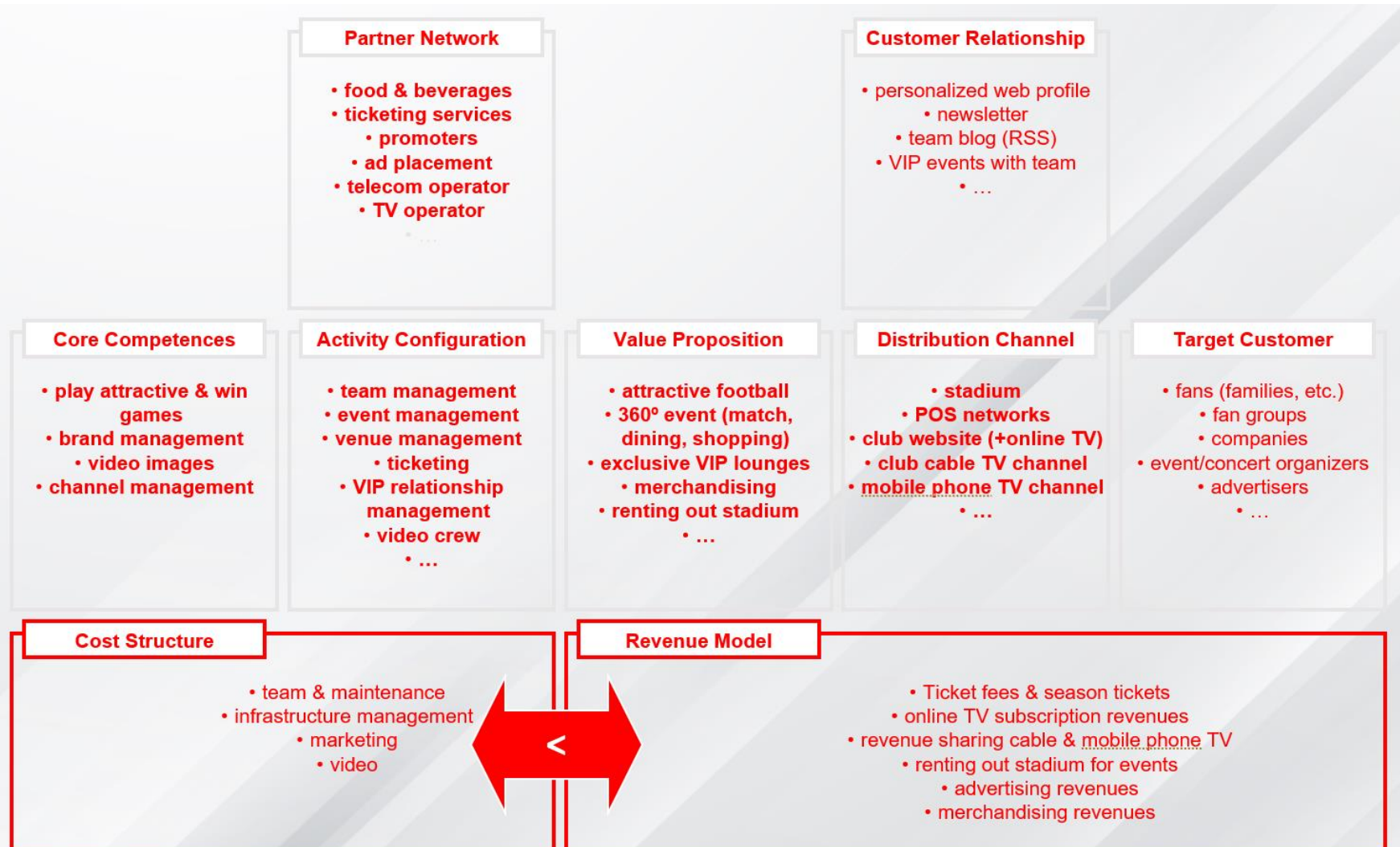
Structuring costs: breakeven model



processes generate costs



and deliver value



Costs

- **Fixed costs** will have to be paid no matter how many units are produced.
- **Variable costs** e.g. material costs per unit will increase as output increases.
- The difference between the variable costs and sales price is known as the '**contribution**'.

What is your unit of sale?

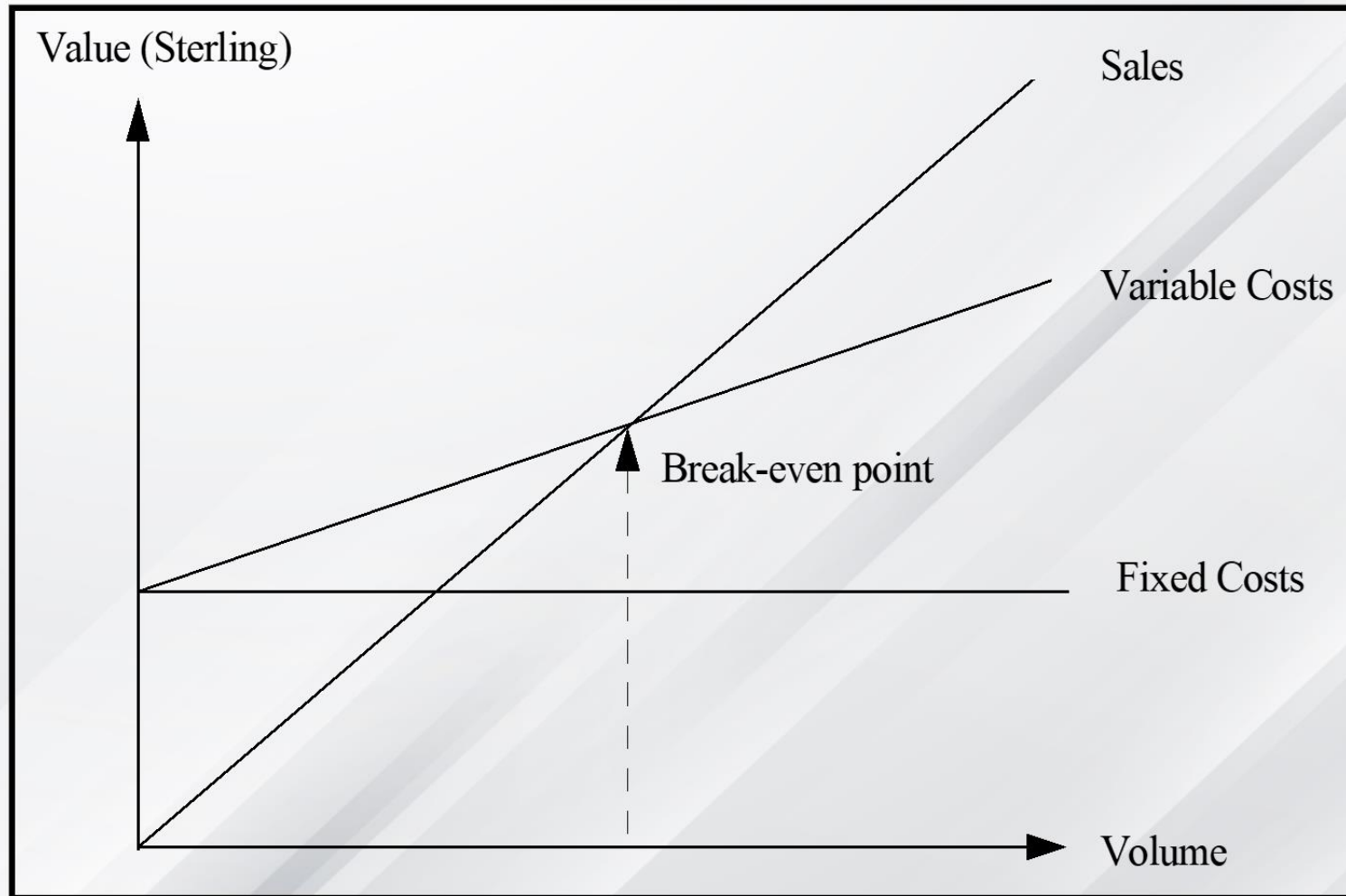
Cathie's colourful carpet

- Selling price £20
- Variable costs £5
- Contribution ($£20 - 5$) £15
- Fixed costs £12000

What are you selling?

- Selling price
- Variable costs
- Contribution per unit
- Fixed costs

Break-even Chart



Construct a Graph: Excel spreadsheet



source: <http://www.tutor2u.net/blog/index.php/business-studies/comments/free-teaching-resource-break-even-simulator>

The breakeven point can also be established using the following calculations:

$$\text{Breakeven point in units} = \frac{\text{Fixed Costs}}{\text{Contribution per unit}}$$

$$\text{Breakeven point Sale Value} = \frac{\text{Fixed Costs}}{\% \text{ contribution}}$$

Cathie's Colourful Carpets

- Calculate the breakeven points for
- Breakeven point in units =
- Breakeven point in sales value =
- **What happens if Cathie reduces her selling price by 10%?**
- Breakeven point in units =
- Breakeven point in sales value =



Break even chart:

- Use it to monitor actual sales and set targets.
- Be honest and again record your assumptions made and check back to sales forecasts, costing and capacity.
- If you do not breakeven in year 1, you need to do this for a 2 year period to find the breakeven point.

Consider :

- How can the business reach breakeven sooner?
- What if the business does not reach breakeven in year 1?
- For your business, what is your unit of sale?
- Do you have more than one product?
- Start thinking about your breakeven model?

Finance and your business plan:

- For your businesses you need to construct a breakeven model and 2 year cashflow
- You need a sales forecast to feed into the income section of the cashflow
- You need to address the funding required and where you will be seeking funding from

Finance (Cash Flow)and Risk



Most new ventures need funding

- Cashflow Challenges – inventory, employees trained & paid, promotional plan put into operation
- Capital Investments – buildings, equipment
- Lengthy New Product Development (NPD)

Cashflow Challenges

- Inadequate financial resources is one of the primary reasons new firms fail
 - For example, a firm usually fails if it burns through all its capital before becoming profitable
- A firm can run out of cash even if it has good customers and products
- Most entrepreneurs need credit or capital to cover cashflow shortfalls

Cashflow forecast

- Shows timings and amounts of all income and expenditure
- Use cash-based accounting
- Individual for the business

For this project, you will need to put your own cashflow spreadsheet together

Cashflow Template

(example template on VISION)

BV L6 Info Copy of Cashflow blank(1) [Compatibility Mode] - Microsoft Excel

	A	B	C	D	E	F	G	H	I	J	K	L	M	N
1	CASH FLOW													
2														
3	Month	1	2	3	4	5	6	7	8	9	10	11	12	Total
4														
5	Income													0
6														0
7														0
8	Loans													0
9	Owner's Equity													0
10	Other													0
11	Sales													0
12														0
13	Total Income	0	0	0	0	0	0	0	0	0	0	0	0	0
14														
15	Expenditure													0
16														0
17														0
18	Rent													0
19	Services (Electricity, Water)													0
20	Telephone (landline & mobile)													0
21	Wages													0
22	Equipment													0
23	Marketing													0
24	Printing and Stationery													0
25	Travel													0
26														0
27														0
28														0
29														0
30														0
31	Total Expenditure	0	0	0	0	0	0	0	0	0	0	0	0	0
32														
33	Cashflow	0	0	0	0	0	0	0	0	0	0	0	0	0
34														
35	Balance	0	0	0	0	0	0	0	0	0	0	0	0	0

How do you establish funding requirement?

- Cashflow forecast
- Month by month projected income and expenditure
- 3-year projection for Bank funding
- 5-year projection for Capital investment

You need a 2-year cashflow forecast in your business plan

Cashflow Assumptions

- Remember to record your assumptions eg.

Income

- Cash received 30 days after sale – *(refer back to your sales forecast)*

Expenses

- Rent & Rates – paid monthly, all inclusive

Funding requirements

- Once you have your cashflow forecast you can look at peak funding requirements. You can then address where the required cash will come from.
- Then feed these figures into your cashflow showing bank loans, investors cash etc coming in and repayments going out! Record assumptions

Risks, problems and assumptions

- This section should accompany the cashflow forecasts
- Do not omit. If you do the reader may think:
 - You are naïve or stupid, or both
 - You hope to pull the wool over the readers eyes
 - You do not have enough objectivity to recognize and deal with assumptions and problems.

Risks

- Addressing these helps you demonstrate that you have thought of them and can handle them:
 - Run out of cash before orders are secured
 - Potential price cutting by competitors
 - Unfavourable industry trends
 - Design or manufacturing costs exceed estimates
 - Sales projections not achieved
 - Do not meet product launch
 - Difficulties in procuring raw materials
 - Difficulties in obtaining bank credit
 - Run out of cash after orders pour in
 - Customers do not pay you

Your Business Plans

- For your businesses you need to construct a **2-year cashflow**
- Use the cashflow to identify how much funding your require to launch your business.
- You need to address the funding required and where you will be seeking funding from. This will be covered next.

Sources of Finance

Finance available (theoretically) (1/3)

INTERNAL sources

Personal funds:

- Savings
- Re-mortgages
- Family and friends
- Retained profit

All firms are started with some investment from owners

Finance available (theoretically) (2/3)

EXTERNAL sources

Debt

- Banks
- Loans

Overdraft

Equity

- Venture capital
- Informal investors
 - Business angels
 - Non-exec. directors

Finance available (theoretically) (3/3)

Public sector:

- Grants
- Soft loans
- Venture capital
- Competitions
- For example, local authority, LEC, regional government, national government, Europe
- Also industry specific – high tech (SMART) or manufacturing

Other liquidity aids

- Hire purchase
- Leasing
- Trade credit
- Factoring services

Venture capital:

- VC companies
- Look for high growth potential → high return
- Look for a strong entrepreneurial team
- Look for a firm offering a USP
- Usually put in a NED for monitoring, networking

- Informal investors: one method of closing the funding gap
- Business angels are very important to the SME sector because:
 - Do not require the quick return that formal VC companies do
 - Are less likely to want direct involvement with the firm
 - Offer smaller financial amounts
 - Can act in consortia
 - Have expertise, experience, contacts
 - – often greatest value
 - Management, strategy, etc...
 - credibility
- Business angel matching services provided, e.g. LINC Scotland



Chapter
08

Informal venture capital: business angels



Thank You